COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, OCTOBER 7, 2002

APPLICATION OF

WASHINGTON GAS LIGHT COMPANY
and
THE SHENANDOAH GAS DIVISION OF
WASHINGTON GAS LIGHT COMPANY

CASE NO. PUE-2002-00319

For approval of amendments to Rate Schedule No. 9, Firm Delivery Service Gas Supplier Agreement

FINAL ORDER

On June 6, 2002, Washington Gas Light Company ("WGL" or "Washington Gas") and the Shenandoah Gas Division ("Shenandoah") (collectively referred to as the "Companies") filed a joint application with the State Corporation Commission ("Commission") for approval of proposed amendments to Rate Schedule No. 9, "Firm Delivery Service Gas Supplier Agreement." In their joint application, the Companies proposed to require Competitive Service Providers ("CSPs") to accept assignment of certain transportation resources when CSPs sell natural gas supplies to the Companies' customers through their retail access programs ("mandatory capacity assignment"). The Companies proposed that all costs associated with the tariff revisions be recoverable through either the Purchase Gas Charge ("PGC") provisions or another existing mechanism. WGL and Shenandoah requested authority to implement mandatory capacity assignment commencing with the November 2002 billing month.

On June 28, 2002, the Commission issued its procedural Order wherein it docketed the matter, directed the Companies to publish notice of the captioned application, and ordered the Companies to serve a copy of the Order on local officials and on all CSPs who have obtained a license pursuant to § 56-235.8 F of the Code of Virginia to provide natural gas supply or aggregation services in the Companies' service territories. The same Order invited interested parties to file comments and requests for hearing by August 12, 2002. Ordering Paragraph (6) of the June 28, 2002, Order provided that any request for hearing must state why the issues raised therein could not be adequately addressed in written comments and directed persons filing a request for hearing and expecting to participate in any scheduled hearing to file a notice of participation as required by Rule 5 VAC 5-20-80 B of the Commission's Rules of Practice and Procedure. The Order also directed the Commission Staff to investigate and file a report on the Companies' application and provided for the Companies to respond to written interrogatories within five (5) calendar days after the receipt of the same.

On August 7, 2002, the Companies filed proof of publication and the proofs of service on local officials and on all CSPs who have obtained a license pursuant to § 56-235.8 F to provide natural gas supply or aggregation services in the Companies' service territories.

On August 9, 2002, Columbia Gas Transmission Corporation ("TCO") filed a Notice of Participation but did not expressly request a hearing in this matter.

On August 13, 2002, Pepco Energy Services, Inc. ("Pepco" or "PES"), filed comments in opposition to the Companies' application. Pepco asserted that it had been able to locate and purchase sufficient capacity to meet its obligations to its customers and that there were sufficient resources available to ensure that competitive suppliers could meet their load obligations. PES commented that the Companies' practice of holding more transportation capacity than required to serve its customers helped to create any illiquidity that may exist in the market. It also alleged that the Companies have not provided documents in support of their allegation that CSPs have not purchased sufficient firm transportation capacity to meet the designated requirements of its customers. Pepco contended that the Companies' proposal would increase supplier costs by restricting the suppliers' ability to assemble a reliable supply portfolio in the most cost effective manner, driving up prices for customers of CSPs and eliminating some suppliers from competing in Virginia.

Pepco further charged that a mandatory capacity proposal failed to recognize capacity obligations that suppliers have incurred and may force suppliers to take additional unnecessary capacity. It maintained that the Companies' existing tariffs provided incentives for suppliers to acquire adequate capacity through penalties or under-deliveries of their Daily Requirements Volumes. PES asserted that the Companies have the ability to issue an operational flow order ("OFO") if, in the Companies' opinion, a supplier's gas deliveries adversely impact the operation of the distribution system. Pepco noted that the penalty for non-compliance with an OFO was $25 per decatherm, and that these penalties should substantially mitigate the Companies' concerns about adequate capacity. Finally, Pepco argued that the filing seeks to allocate inequitably costs to captive customers and captive suppliers. It argued that the cost recovery methodology, as well as the reasonableness and prudence of the costs, should be subject to a thorough Commission review once an appropriate application concerning the recovery of costs associated with the Companies' provision of a regulated service was before the Commission.

On August 16, 2002, the Commission entered an Order extending the time for consideration of the application for the maximum period permitted under § 56-235.8 of the Code of Virginia; i.e., December 3, 2002, to consider the issues raised by the Companies' application, accepted PES' comments out of time, and permitted the Companies to file pleadings or other documents responsive to the Staff Report, Pepco's comments, and the Notice of Participation filed by TCO.

On August 22, 2002, the Staff filed its Report in the matter. Staff noted that the Companies plan to provide natural gas retail supply choice to all of their customers in Virginia, subject to the conditions set forth in the Commission's March 7, 2001, Order approving WGL's retail access plan, entered in Case No. PUE-2000-00474. According to Staff, under WGL's retail supply choice plan, CSPs are required to match their daily deliveries to the Companies' city-gates to the daily load requirements of their customers in the same way the Companies are required to do so in compliance with interstate pipeline requirements. CSPs are assigned storage and peak resources from the Companies' portfolio to meet the variable and extreme weather characteristics of their customers' loads. These services are assigned and released to CSPs at the Companies' cost. At WGL's discretion, CSPs may exercise an optional assignment of the Company's firm transportation for up to 100% of their firm transportation capacity requirements.

Among other things, the Staff noted that the Companies' proposal would require CSPs to take assignment of a proportionate amount of the Companies' firm transportation capacity and to pay Federal Energy Regulatory Commission ("FERC") approved pipeline rates identical to the rates paid by the Companies. As the load requirements of a CSP change from month to month due to growth or a decline in the number and types of customers served by the CSP, the capacity assigned would be adjusted, similar to the current process for adjusting storage and peaking resources.

Staff also commented on the reliability of secondary and interruptible transportation capacity in its Report. It noted that during an interim period of growth, distribution companies or any other entities that may have executed a long-term contract for capacity with a pipeline company, will often release any capacity not being utilized to meet their immediate supply requirements into the secondary market. According to Staff, CSPs relying on secondary market capacity to meet their supply needs may face constraints when primary holders of capacity require the capacity, and it is no longer available for release. When this occurs, according to Staff, CSPs could find that secondary capacity could actually become more costly than primary capacity or may be unavailable. The reliability of firm and interruptible transportation capacity is dependent upon the conditions in the capacity market itself. Staff opined that secondary firm capacity may not be so reliable as primary firm transportation capacity, thus exposing residential and small commercial customers to more risk than they have been exposed to historically. According to Staff, Virginia's natural gas utilities have relied upon primary firm transportation capacity to serve their residential and small commercial load. Staff observed that as the supplier of last resort, the Companies have an obligation to provide tariffed gas service to any customer not receiving service from a CSP as well as to those who choose to receive gas supplies from a CSP, but then later return to the Company's sales service. Staff acknowledged that all participants in the energy market, including WGL, are faced with the problem of customers switching energy suppliers, but CSPs are not faced with the same customer service requirements as local distribution companies that are default service providers. CSPs, in contrast, may refuse to accept new customers, refuse to renew service to existing customers, or discontinue service altogether by exiting the Companies' retail access program.

Staff noted that the recovery of costs associated with reserve requirements was addressed in WGL's application for a retail supply choice plan docketed as Case No. PUE-2002-00474. In that case, a cap was established in the gas supply realignment adjustment ("GSRA") surcharge applicable to residential firm sales customers. Staff reported that the GSRA was limited to recovery of transition costs and commented that stranded capacity costs were intended to be primarily recovered from residential customers not using WGL's capacity. Therefore, according to Staff, such costs were not intended to be recovered through the PGA as gas costs. Staff commented that WGL must be prepared to provide service to choice customers that return to its sales service although it was unlikely that all of these customers would choose to return to sales service or that all CSPs would exit WGL's program at the same time. Thus, according to Staff, as the choice market develops, some lesser capacity reserve may be sufficient for WGL.

Staff observed that the potential cost associated with mandatory capacity assignment is that if it is not absolutely necessary, i.e., that the capacity CSPs have contracted for themselves is reliable enough, supplier costs may be needlessly increased, and the supplier's ability to assemble the most cost effective supply portfolios may be restricted. The potential benefits for mandatory capacity are that the Companies will be able to ensure that adequate primary firm transportation capacity will always be available to its city-gate.

Staff generally supported the Companies' mandatory capacity proposal but observed that suppliers may have already contracted for capacity to meet some or all of their expected load for the winter. Staff therefore recommended that WGL be required to phase-in its mandatory capacity plan over a one-year period, in a manner that does not force CPSs to acquire excess capacity.

Finally, Staff observed that it reviews the reasonableness of the Companies' purchase gas costs and commented that any such costs could be excluded from recovery in the Companies' PGA, GSRA, or reserve capacity if these costs were found to be imprudent.

On September 6, 2002, the Companies filed their response to the Staff Report, the Comments of Pepco, and the Notice of Participation filed by TCO. In that response, the Companies noted that they were addressing short- and long-term reliability to their customers by their mandatory capacity proposal. They explained that as the suppliers of last resort, they must be concerned about the availability of upstream capacity to meet their service obligations over the long-term. According to WGL and Shenandoah, three interstate pipelines with direct connections to WGL, TCO, Transcontinental Gas Pipe Line Company ("Transco"), and Dominion Transmission Corporation ("DTI") are all fully subscribed in the Mid-Atlantic region. Between November 2002, and November 2006, WGL must decide whether to return or terminate 199,045 Dths of pipeline transportation capacity with a primary delivery point to the Company's city-gate and 310,321 Dths of upstream, firm pipeline transportation capacity. According to the Companies, with the current capacity shortage in the Mid-Atlantic region, and with the Company's distribution system not having been tested on a "design day" for several years, the prudent course of action is to retain capacity, particularly when under the FERC's right of first refusal procedure, the maximum commitment term for rollover of existing capacity contracts is five years, compared to the 10 to 15 years traditionally associated with new or open-season capacity projects. The Companies reason that if capacity is contracted for to serve a new load or a new market, that capacity will no longer be available to the Companies or to CSPs to provide service to the Companies' customers. Mandatory assignment of a proportionate share of such capacity to CSPs selling gas supplies to firm customers in the Companies' retail access program would, according to the Companies, be the fairest way to ensure that those who stand to benefit from such capacity pay all applicable costs.

The Companies generally supported the Staff's recommendations, including Staff's proposal that they be required to phase-in mandatory capacity assignment over a one-year period, in a manner that does not force CSPs to acquire excess capacity. They further proposed that a CSP should be required to demonstrate that capacity commitments were contracted for prior to the date of a final order in the captioned proceeding and with entities meeting the Companies' reliability and credit standards.

The Companies expressed the concern that absent mandatory capacity assignment, sales customers may subsidize delivery service customers through the operation of the GSRA provision described in General Service Provision ("GSP") No. 25 of the Companies' tariff. They explained that GSP No. 25 permits the recovery, through the GSRA, of costs related to the release of firm transportation capacity no longer required to serve firm sales customers because customers have elected to acquire gas supplies from CSPs, less any revenues received by the Companies through the release and sale of such capacity. The Companies commented that if the level of "transition costs" do not trigger the current GSRA factor cap,[1] then some level of "stranded" capacity costs could be recovered from firm sales customers through the GSRA. According to the Companies, these types of costs are more appropriately recovered from delivery service customers - a circumstance addressed by mandatory capacity assignment.

The Companies also addressed PES' comments regarding penalties for under-deliveries. They contend that the existing tariff penalties for under-deliveries were intended to provide incentives to CSPs to meet delivery obligations on a daily

[1] The current monthly GSRA factor cap for Shenandoah is $0.0099 per ccf and is found in General Service Provision No. 23 (C)(3), Residential Factor Allocation Cap of Shenandoah's tariff. For WGL, the monthly per therm "current" factor is $0.0082. Staff Report at 14.

basis, particularly on days when the Companies may not be able to acquire alternative gas supplies in the event a CSP fails to deliver. The Companies noted that holding capacity does not guarantee delivery of gas and delivery failures may occur because of gas supply constraints. The Companies, therefore, reasoned that existing penalties are necessary even if the mandatory capacity assignment proposed is approved by the Commission. They stated that in the event the CSP elected to terminate service in the Companies' retail access program, they must be in a position to "backstop" all CSPs and to provide reliable service with little or no notice. The Companies urged the Commission to approve their proposed revisions to Rate Schedule No. 9, adopting mandatory capacity assignment as part of the Companies' retail access program.

NOW, UPON CONSIDERATION of the foregoing, the Commission is of the opinion and finds that the Companies' application to revise Rate Schedule No. 9 for their respective retail access programs should be approved, subject to the modification proposed by the Staff at page 16 of the August 22, 2002, Staff Report.[2] Revision of the Companies' tariffs in this manner

[2] In our June 28, 2002, Order entered in Phase I of Application of Columbia Gas of Virginia, Inc., For Approval of a Retail Supply Choice Plan as Authorized by § 56-235.8 of the Code of Virginia, Doc. Con. Cen. No. 020650134, at p. 9, we accepted Staff's proposal to provide for mandatory capacity assignment of upstream firm transportation service to CPSs as part of Columbia Gas of Virginia, Inc.'s retail access plan.

should permit WGL and Shenandoah to assure the reliable delivery of natural gas to all WGL and Shenandoah customers, including those participating in the Companies' retail access programs.

Further, we find that the Companies should modify their respective tariffs to permit CSPs to demonstrate to the Companies that their capacity commitments were contracted for prior to the date of this Order, as the mandatory capacity assignment provisions are implemented over a period of a year. Additionally, we will not require a CSP to provide proof to the Companies regarding the reliability and credit status of the entity with which the CSP may have contracted for capacity. We have not previously imposed this requirement. There has been no showing of operational difficulties absent such requirement, or that such requirement is necessary for the future. Moreover, as mandatory capacity assignment is phased in, the Companies' concerns in this regard should diminish.

Accordingly, IT IS ORDERED THAT:

(1) The Companies' June 6, 2002, application to approve the proposed amendments to Rate Schedule No. 9, "Firm Delivery Service Gas Supplier Agreement," as modified by the findings made herein, is hereby approved.

(2) WGL and Shenandoah shall forthwith file revised tariffs, reflecting the changes directed herein, with the

Division of Energy Regulation, to be effective for meter readings made on and after the date of this Final Order.

(3) There being nothing further to be done herein, this matter shall be dismissed from the Commission's docket of active proceedings and the papers filed herein made a part of the Commission's file for ended causes.